

TEST YOURSELF ON THE ACCOUNTING CYCLE

True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

- T F 1. In a prosperous and liquid business the accounts with credit balances will normally exceed in total dollar amount the accounts with debit balances.
- T F 2. The term *debit* may signify either an increase or a decrease; the same is true of the term *credit*.
- T F 3. A business transaction is always recorded in the ledger by entries to two or more different ledger accounts.
- T F 4. An entry on the left side of a ledger account is called a debit entry and an entry on the right side is called a credit entry, regardless of whether the account represents an asset, a liability, or owners' equity.
- T F 5. Accounts representing items which appear on the left-hand side of the balance sheet usually have credit balances.
- T F 6. A trial balance with equal debit and credit totals proves that all transactions have been correctly journalized and posted to the proper ledger accounts.
- T F 7. The sequence of the account titles in a trial balance depends upon the size of the account balances.
- T F 8. A journal entry may include debits to more than one account and credits to more than one account but the total of the debits must always equal the total of the credits.
- T F 9. If a business transaction is recorded correctly, it cannot possibly upset the equality of debits and credits in the ledger.
- T F 10. In a journal entry recording the purchase of a desk for \$275.80, both the debit and credit were recorded and posted as \$257.80. This *transposition error* would *not* be disclosed by the preparation of a trial balance.
- T F 11. The double-entry accounting system means that transactions are recorded both in the journal and in the ledger.
- T F 12. An income statement relates to a specified period of time whereas a balance sheet shows the financial position of a business at a particular date.
- T F 13. The realization principle states that a business should never record revenue until cash is collected from the customer.
- T F 14. Expenses cause a decrease in owners' equity and are recorded by debits.
- T F 15. If cash receipts are \$10,000 greater than total expenses for a given period, the business will earn a net income of \$10,000 or more.

- T F 16. The journal entry to recognize a revenue or an expense usually affects an asset or liability account as well.
- T F 17. Under accrual basis accounting, revenue is recognized when cash is received, and expenses are recognized when cash is paid.
- T F 18. An expense may be recognized and recorded even though no cash outlay has been made.
- T F 19. Buying a building for cash is just exchanging one asset for another and will not result in an expense even in the future.
- T F 20. Revenue increases owners' equity and is recorded by a credit.

Completion Statements

Fill in the necessary word to complete the following statements:

- Increases in assets are recorded by _____, and decreases in assets are recorded by credits; increases in accounts appearing on the right side of a balance sheet are recorded by _____, while decreases in those accounts are recorded by _____.
- In accounting, the term *debit* refers to the _____ side of a _____, while the term *credit* refers to the _____ side.
- Asset accounts appear on the _____ side of the balance sheet and normally have _____ balances. Liability and owners' equity accounts appear on the _____ side of the balance sheet and normally have _____ balances.
- When a company borrows from a bank, two accounts immediately affected are _____ and _____. The journal entry to record the transaction requires a _____ to the first account and a _____ to the second one.
- A _____ is prepared from the ledger accounts at the end of the month (or other accounting period) in order to prove that the total accounts with _____ is equal to the total accounts with _____.
- The _____ principle of accounting states that revenue should be recognized in the period that it is earned. The _____ principle indicates that expenses should be recognized in the period in which they help produce _____.
- The principle distinction between expenses and dividends is that expenses are incurred for the purpose of _____.

Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

- ___ 1. A **ledger** contains a separate "account" for each:
 - a. Business transaction.
 - b. Business day.
 - c. Asset, liability, and element of owners' equity.
 - d. Journal entry.

- ___ 2. Which of the following statements about the rules for debiting and crediting balance sheet accounts is **not true**?
 - a. Liability accounts are reduced by debit entries.
 - b. Accounts on the left side of the balance sheet are reduced by credit entries.
 - c. Each transaction is recorded by equal dollar amounts of debits and credits.
 - d. Owners' equity accounts and asset accounts are increased by debit entries.

- ___ 3. The key point of **double-entry accounting** is that every transaction:
 - a. Is recorded by equal dollar amounts of debit and credit entries.
 - b. Is recorded in both the journal and the ledger.
 - c. Affects both sides of the balance sheet.
 - d. Is both recorded and posted.

- ___ 4. A **journal** consists of:
 - a. A listing of the balances of the accounts in the ledger.
 - b. A storage center of information within a computer-based system.
 - c. A chronological record of individual business transactions.
 - d. a separate "account" for each asset, liability, and element of owners' equity.

- ___ 5. The purpose of a **trial balance** is:
 - a. To determine that journal entries are in balance before posting those entries to the ledger.
 - b. To indicate the effects of business transactions.
 - c. To prove the equality of debits and credits in the ledger.
 - d. To determine that the number of ledger accounts with debit balances is equal to the number of credit balances.

- 6. Red Hill Vineyards completes a transaction which causes an asset account to decrease. Which of the following *related effects* may also occur?
- a. An increase of equal amount in a liability account.
 - b. An increase of an equal amount in owners' equity.
 - c. An increase of an equal amount in another asset account.
 - d. None of the above.
- 7. The *time-period principle*:
- a. Requires that all companies prepare monthly, quarterly, and annual financial statements.
 - b. Involves dividing the life of a business entity into accounting periods of equal length.
 - c. Requires all companies to use a fiscal year ending December 31.
 - d. Stems from the Internal Revenue Service requirement that taxable income be reported on an annual basis.
- 8. The *realization principle*:
- a. Indicates that a business should record revenue when services are rendered or merchandise sold is delivered to customers, even if cash has not yet been received.
 - b. Indicates that revenue should be recognized in the accounting period when cash is received, even if the business has not yet performed all the required services.
 - c. Indicates that revenue should be recorded only after two conditions have been met: (1) the earning process is complete, and (2) the cash has been collected.
 - d. Provides guidelines as to when expenses should be recognized.
- 9. A produce supplier enters into a contract with a supermarket chain on September 8 to deliver pumpkins in October. The pumpkins are delivered on October 14 at a price of \$4,000, \$2,000 payable on November 1, and \$2,000 December 1. When should the produce supplier record the \$4,000 as revenue?
- a. September 8.
 - b. October 14.
 - c. \$2,000 November 1, and \$2,000 December 1.
 - d. When the supermarket sells the pumpkins.
- 10. The *matching principle* implies that expenses:
- a. Should be deducted from revenue in the period which the suppliers of the goods or services are paid.
 - b. For a period should be equal in amount to the revenue recognized during the period.
 - c. Should be deducted in the period in which use of the related goods or services help to produce revenue.
 - d. Should be equal to the cash payments made during the period.

11. On April 1, Hudson Company received and paid a \$700 bill for advertising done in March. In addition to this bill, the company paid \$6,100 during April for expenses incurred in that month. On May 2, Hudson Company paid a \$4,600 payroll to employees for work done in April. Based on these facts, total expenses for the month of April were:
- \$ 6,100.
 - \$ 6,800.
 - \$10,700.
 - \$11,400.
12. If a journal entry recognizes an expense, the entry might also:
- Increase an asset account.
 - Decrease the Capital Stock account.
 - Decrease a liability account.
 - Increase a liability account.

Exercises

1. Listed below are eight technical accounting terms emphasized in this chapter.

Trial Balance
Debit
Revenue
Net income

Accounting Cycle
Realization principle
Accrual accounting
Credit

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms.

- An eight-step process by which economic events are initially captured and transformed into financial statements.

- The price of goods sold and services rendered during the period.

- Revenue earned less expenses incurred during the period.

- A two-column schedule listing all of the accounts in the general ledger and their respective balances.

- e. The generally accepted accounting principle that expenses are to be recognized in the period that the related expenditure helps to produce revenue.
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- f. The right-hand side of a ledger account.
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- g. The technique of recognizing revenue when it is earned and expenses when the related goods and services are used, without regard to when cash is received or paid.
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2. Show the change in total assets, total liabilities, and total owners' equity that will be caused by posting each amount in the following journal entries. In the effect of transaction row, show the total change in assets, liabilities, and owners' equity that has occurred after all parts of the transaction have been posted. Hint: The effect of each transaction should be that the total change on the left side of the balance sheet (change in assets) should equal the change on the right side (change in liabilities + change in owners' equity). Explanations have been omitted from journal entries to conserve space.

Journal Entry	Dr	Cr	Assets	=	Liabilities	+	Owners' Equity
Example:							
Office Equipment	600		+600				
Cash		150	-150				
Accounts Payable		450			+450		
Effect of transaction			+450	=	+450	+	0
a. Cash	1,230						
Accounts Receivable		1,230					
Effect of transaction				=		+	
b. Cash	5,000						
Capital Stock		5,000					
Effect of transaction							
c. Cash	3,800						
Notes Payable		3,800					
Effect of transaction				=		+	
d. Accounts Payable	350						
Cash		350					
Effect of transaction				=		+	
e. Land	9,000						
Cash		1,000					
Notes Payable		8,000					
Effect of transaction				=		+	

3. A list of accounts for Jones Company is given below followed by a series of transactions. Indicate the accounts that would be debited and credited in recording each transaction by placing the appropriate account number(s) in the space provided

1. Cash
2. Accounts Receivable
3. Office Equipment
4. Accumulated Depreciation: Office Equipment
21. Notes Payable
22. Accounts Payable
31. Capital Stock
35. Retained Earnings
41. All Revenue Accounts
51. All Expense Accounts
99. Dividends

Transactions	Accounts(s) Debited	Accounts(s) Credited
Example Purchased office equipment, paying part cash and issuing a note payable for the balance	3	1,21
a. Paid creditor amount due on open account		
b. Collected from customer for services performed by Jones Company in previous period		
c. Utility bill is received; payment will be made in 10 days		
d. Performed services for a customer; \$50 cash received and the balance due in 30 days		
e. Office equipment purchased giving note payable		
f. Made a Cash distribution to the stockholders.		

4. Indicate the effects that each of these transactions will have upon the following six **total amounts** in the company's financial statements for the month of May. Use the code letters **U** for Understated, **O** for Overstated, and **NE** for No Effect.

Error	Income Statement			Balance Sheet		
	Total Revenue	Total Expenses	Net Income	Total Assets	Total Liabilities	Owners' Equity
Example: Rendered services to a customer and received immediate payment in cash but made no record of the transaction	<i>U</i>	<i>NE</i>	<i>U</i>	<i>U</i>	<i>NE</i>	<i>U</i>
a. Payment for repairs erroneously debited to Building account						
b. Recorded collection of an account receivable by debiting Cash and crediting a revenue account.						
c. Recorded twice revenue earned on account.						
d. Recorded twice a purchase of office supplies on credit						
e. Recorded the purchase of office equipment for cash as a debit to Office Expense and a credit to Cash.						
f. Recorded cash payment for utilities by debiting Repairs Expense and crediting Accounts Payable.						